

STATE OF MAINE  
PUBLIC UTILITIES COMMISSION

Docket No. 97-796

March 26, 1998

BANGOR HYDRO ELECTRIC COMPANY  
Petition for Affiliated  
and Reorganization  
Approval Needed in Connection with  
Bangor Gas Company Transaction

ORDER REJECTING  
STIPULATION AND  
APPROVING SECOND  
REVISED STIPULATION

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WELCH, Chairman; NUGENT and HUNT, Commissioners

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## **I. SUMMARY OF DECISION**

In this Order, we reject the original Stipulation filed in the above matter on behalf of Bangor Hydro-Electric Company (BHE), Bangor Gas Company, LLC (BGC), Maritimes and Northeast Pipelines, LLC (Maritimes), and the Public Advocate. We conclude that the original Stipulation (Stipulation) is inconsistent with the determinations the Commission is required to make pursuant to 35-A M.R.S.A. §708 and inconsistent with the Commission policy set forth in the Commission's order provisionally adopting Chapter 820 of the Commission's rules. Because the Second Revised Stipulation filed in this matter, addresses our concerns, we approve that stipulation.<sup>1</sup>

## **II. PROCEDURAL HISTORY**

On October 29, 1997, BHE filed, together with BGC, a Consolidated Petition in which BHE requested authority to participate in Bangor Gas, and Bangor Gas requested authorization to provide gas service as a public utility gas company serving the greater Bangor area. On November 14, 1997, the Commission notified BHE that its filing was found to be complete as of November 12, 1997, the date on which BHE filed certain additional information requested by the Commission. On November 18, 1997, the Examiners entered an order denying a motion of BGC and BHE to consolidate their cases. Accordingly, all approvals and exemptions required for BHE to participate in Bangor Gas have been processed in this Docket, and all issues relating to BGC's petition to serve, and related requests for approvals and exemptions, are being processed in Docket No. 97-795. The parties in this case, BHE, the Public Advocate, BGC, Maritimes and Central Maine Power Company (CMP) participated in a prehearing conference and two technical conferences. The Advisors and the parties conducted discovery, both written and orally at technical conferences, to which BHE has responded.

On February 19, 1998, counsel for BHE filed a stipulation on behalf of BHE and the Public Advocate. BGC and Maritimes also

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<sup>1</sup> Central Maine Power Company neither signed nor objected to either stipulation.

signed the Stipulation. Through the Stipulation, the signatories sought to resolve all issues in this case. All discovery, transcripts of technical conferences, testimony and exhibits included in the October filing as supplemented were considered part of the record for the purpose of determining whether the Commission should accept the Stipulation. The parties waived the right to file objections to an Examiner's report. The Advisors issued a written recommendation to the Commission and provided the parties with copies of the recommendation. The Advisors recommended rejection of the Stipulation and provided recommended guidelines for an acceptable outcome to the proceeding. The Commission considered the Stipulation during its deliberative session on March 9, 1998. As described below, the Commission rejected the Stipulation.

The parties then submitted a revised stipulation, based on the Advisors' recommendations. The parties further revised the stipulation following a conference of counsel and submitted the Second Revised Stipulation for Commission approval. All parties but CMP signed the Second Revised Stipulation. CMP does not object to Commission approval of the Second Revised Stipulation but filed comments relating to the stipulation. The parties to the Second Revised Stipulation agreed that the Commission may rely on discovery, as well as all testimony and exhibits in BHE's October filing, in determining whether to approve the Second Revised Stipulation.

### **III. DESCRIPTION OF ORIGINAL STIPULATION**

#### **A. Investment**

The original Stipulation submitted on February 19, 1998 allowed BHE to invest up to \$600,000 in Gassub, for the purpose of funding Gassub's initial capital contribution to Bangor Gas. The Stipulation further allowed an additional investment of \$375,000 in development costs by providing that these development costs should not be considered in determining whether the \$600,000 capital contribution limitation should be met.<sup>2</sup> The Stipulation further allowed the Commission to revoke the authority to invest in the event that BHE initiated a filing under Section 1322 of Title 35-A seeking an emergency rate increase or if the Company initiated insolvency proceedings.

The Stipulation also allowed BHE to file for additional approval to make an additional capital contribution, through Gassub, to Bangor Gas in April of 1999 for an amount to be determined by the management and the Board of BHE, but "which may be on the order of \$3,150,000 (equal to (a) the balance of the full contribution that BHE would have made in October of 1998, but for the deferral of all but 20% of such contribution, plus

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<sup>2</sup> We note that the operating agreement and the testimony of Frederick Samp identify development costs as an additional capital contribution.

(b) 20% of its April, 1999 contribution)." The Stipulation further provided that the supplemental filing may be made in the first quarter of 1999 and that the Commission will process the filing in 60 rather than the 120 days provided for under section 707 of Title 35-A or 180 days (if the investment is considered a reorganization). In the second proceeding, the Commission would establish the scope of any additional proceedings regarding approval of any further capital contributions which BHE may make in the third and fourth quarters of 1999.

B. Formation of Gassub

The Stipulation provided that BHE may form Gassub which will be wholly-owned by BHE. The purpose of Gassub is to hold BHE's interest in BGC and otherwise to serve as a vehicle for BHE's participation in BGC. The provisions relating to Gassub are those set forth in the operating agreement. The Stipulation also provided that the Commission shall have reasonable access to Gassub's books and records.

C. Conditions of BHE's Participation

The Stipulation adopted conditions regarding BHE's investment and participation in BGC and (Gassub) discussed in Frederick Samp's Prefiled Testimony at pages 24 and 25. These provisions included a requirement that all costs, revenues and investments and all profits and losses, associated with or resulting from BHE's participation in Bangor Gas and Gassub would be accounted for in a manner consistent with the relevant accounting procedure set forth in Chapter 820 of the Commission's rules, as finally adopted. This provision also included below-the-line ratemaking treatment for BHE's participation in Gassub and BGC (including development costs).

D. BHE Affiliated Transactions Approval

The Stipulation authorized BHE to enter into the support services agreement with Bangor Gas and Energy Pacific (Exhibit C to BHE's October filing) and to enter into the Funding Agreement that was attached as Exhibit A to the Stipulation.

E. Value of BHE Name and Allocation of Value

The Stipulation provided for the value of goodwill as established under Section 4.1 of the Operating Agreement as amended by a letter agreement with Bangor Pacific dated February 19, 1998 and filed at the Commission on February 19, 1998. This provision values the use by BGC of the BHE's name at

two percent of BGC's pre-tax net income for the period ending on December 31, 2006. The Stipulation further provided that only 50% of the value of the payment shall be allocated to ratepayers.

#### IV. DESCRIPTION OF SECOND REVISED STIPULATION

The Second Revised Stipulation includes the following provisions:

- (1) it allows an investment in October of 1998 or thereafter of \$375,000 in development costs and a capital contribution of up to \$2.5 million conditioned upon BHE showing that it is in sound financial condition. BHE is required to make a supplemental filing to establish that the Company is in financially sound condition consistent with the requirements of Chapter 820 and Section 708 of Title 35-A. If BHE fails to establish that it is in sound financial condition, the Commission's approval to invest will be revoked. The determination of whether BHE has made the required showing will be made within 90 days of the date of the filing;
- (2) it identifies the value of the use of BHE's name at two percent of BGC's pre-tax net income for the period ending on December 31, 2006, except that the annual payment shall continue if BGC continues to use BHE's name after December 31, 2006 (unless continued payments are prohibited under Chapter 820, as finally adopted);
- (3) it allocates the value of BHE's name entirely to ratepayers;
- (4) it requires that if BGC and BHE decide to engage in joint marketing, beyond the minimal use of BHE's name as described in Advisors 01-26 and 02-09 **confidential**, BHE must report its intention to commence such activity at least 30 days in advance of commencing the joint marketing; this report may trigger a reopening of the case to redetermine the value of good will and company name and may also result in the imposition of additional standards of conduct;
- (5) it provides for a new filing for affiliated transaction and reorganization approval for any additional investment that BHE proposes to make in Bangor Gas (through Gassub);
- (6) it requires that all transactions between Bangor Hydro and Bangor Gas be in accordance with the provisions of Chapter 820, as finally adopted;

- (7) it provides for below-the-line ratemaking treatment for BHE's participation in Gassub and BGC, except for payments for use of BHE's name;
- (8) it allows for the formation of Gassub;
- (9) it provides that BHE's ratepayers shall be held harmless from any and all negative consequences flowing from BHE's investment and participation in Bangor Gas;
- (10) it provides that the Commission shall have reasonable access to Gassub's books and records;
- (11) it requires that the supplemental filing contain a projection of cash flow and earnings, current bond rating, an indication of whether parties to the BHE's Credit Agreement have approved the investment, an update on financing for the PERC transaction and the Unitel monetization and a description of the source of funds for the investment; and
- (12) it allows BHE to enter into the support services agreement and the funding agreement (appended to the Second Revised Stipulation) under specific terms set forth in the stipulation.

The Second Revised Stipulation also expresses the parties' intent that the Bangor Gas Company application for an unconditional certificate to provide gas service in the greater Bangor area would not be affected by the determination of whether BHE is permitted to invest in the venture.

## **V. DISCUSSION**

We reject the original Stipulation because at this time, we cannot determine or find that BHE is in financially sound condition and as a result cannot make findings required by 35-A M.R.S.A. § 708(2) to ensure that ratepayers are adequately protected. The Second Revised Stipulation addresses our concern about adequate ratepayer protection because it requires BHE to show that it is in sound financial condition as a condition of our approval to permit it to invest in BGC.

In Docket No. 97-116, we granted BHE a rate increase of \$13,222,365. In that case we described BHE's financial condition as "relatively precarious." *Bangor Hydro-Electric Company Proposed Increase in Rates*, Docket No. 97-116, Order at 59 (Feb.9, 1998). We also noted that BHE is in a state of "financial turmoil." *Id.* at 5.

In this case, BHE stated that its bond rating is below investment grade. It also has stated that it has not identified the source of funds to make its originally proposed \$2.5 million

investment, and that it does not intend to approach the banks that are parties to its Credit Agreement for approval of the investment until late summer if at that time approval is needed. BHE concluded that by the time it is required to make its investment in October of 1998, its financial condition will improve as a result of the rate increase it expected to receive from the Commission.<sup>3</sup> At this time, however, there is no evidence on which we can determine that the Company will be in a sound financial condition in October of 1998.

At the technical conference held on January 13, 1998, the Public Advocate expressed concern with approving an investment without the opportunity to determine whether BHE's financial condition improved as a result of the rate increase granted in Docket Number 97-116. The Public Advocate stated that BHE should not be allowed to invest at this time because of the Company's weak financial condition. He suggested that it is too early to assess the impact of the rate increase granted in Docket Number 97-116 on BHE's financial condition and that it would be more appropriate for BHE to make a new or supplemental filing for approval of the investment once the Company's financial condition has improved. The Public Advocate also stated that it might be appropriate to grant conditional approval of an investment which would require the Company to show that it has enough cash and that the investment would not drain cash away from core operations of the Company.

In response to Chairman Welch's suggestion of the possibility of (1) either denying approval to BHE to invest money in October but allowing the Company to make a showing in July that the company's financial condition has sufficiently improved to permit an investment or (2) granting approval for investment in October but conditioning approval upon BHE showing in a July filing that BHE's financial situation is sound enough to permit it to invest in Bangor Gas, Mr. Samp, on behalf of BHE, stated that although BHE preferred to have approval to invest in the project, the Company was not opposed to the Commission granting approval to invest conditioned upon BHE showing that it is in sound financial condition. Counsel for BGC indicated that the Bangor Gas project could go forward even if BHE did not invest in it.

Contrary to the discussion at the technical conference, the original Stipulation allows BHE to invest almost \$1 million without any showing that the Company will be in sound financial condition.<sup>4</sup> We conclude that because BHE has not shown that the

<sup>3</sup> BHE sought a rate increase of \$22.11 million. The Commission granted a rate increase of \$13,222,365 on February 9, 1998, after BHE made these statements.

<sup>4</sup> The original Stipulation does not require BHE to wait until October to make the investment, assuming it could find the cash or credit and get approval under its Credit Agreement before that

Company is or will be in sound financial condition, BHE has not established that the reorganization is consistent with the interest of the utility's ratepayers and investors as required by 35-A M.R.S.A. § 708(2). Because of the Company's failure to establish that it is in sound financial condition, we also can not make the requisite determinations pursuant to section 708 of Title 35-A.<sup>5</sup>

Moreover, the Commission has recently determined in its Chapter 820 rulemaking that a utility that is not in sound financial condition should not be allowed to invest in non-core activities. The reason for the bar is that it is in the ratepayers' interest to require a utility that is not financially sound to focus its resources on rebuilding the financial integrity of the core business. Unless the utility is in sound financial condition, provisions requiring a utility to hold ratepayers harmless for the negative consequences of a utility's investment in non-core activities do not provide adequate protection. Simply disallowing costs associated with the investment for a company that is already financially troubled may result in further harm to the utility's ratepayers. In addition, in a rate case it may be difficult to separate and quantify the adverse effects on credit and access to capital resulting from a non-core investment from other circumstances that may be contributing to the utility's troubled financial circumstances. The fact that the initial proposed investment has been reduced from \$2.5 million to nearly \$1 million does not provide adequate assurance of ratepayer protection given the continued uncertainty about BHE's future financial picture. Although the original Stipulation provides that investment approval is revoked if the Company files for an emergency rate increase pursuant to 35-A M.R.S.A. §1322, or if the Company files for bankruptcy, these provisions do not ensure that the Company can afford to direct any money away from its core operations.

The Second Revised Stipulation, on the other hand, requires BHE to demonstrate that it is in sound financial condition consistent with the requirements of Chapter 820, as finally adopted, and section 708 of Title 35-A. Chapter 820 as provisionally adopted bars (absent a waiver) investment in an

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time.

<sup>5</sup> Section 708 of Title 35-A requires that the Commission, if it grants approval, is required to impose certain terms and conditions or requirements necessary to protect ratepayers. Such conditions include provisions that assure that the utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure is not impaired; that the ability of the utility to provide safe, reasonable and adequate service is not impaired; that the utility's credit is not impaired or adversely affected, and that neither ratepayers nor investors are adversely affected by the reorganization. 35-A M.R.S.A. §708(2).

affiliate by a utility that has not attained an investment grade bond rating or that has filed for or been granted a temporary rate increase pursuant to 35-A M.R.S.A. § 1322. If the rule, as finally adopted, does not contain these restrictions, we would still determine pursuant to section 708 of Title 35-A whether BHE is financially sound. The Company could, however, seek to establish that it is financially sound notwithstanding its bond rating or its need for emergency rate relief.<sup>6</sup> Thus, the Second Revised Stipulation provides adequate assurance that approval of the investment with certain specified conditions affords sufficient ratepayer protection.<sup>7</sup> The Second Revised Stipulation also permits the Bangor Gas project to move forward whether or not BHE is permitted to invest in BGC.

The original Stipulation also was inconsistent with the method of allocating the value of intangibles set forth in the Commission's provisionally adopted chapter 820. The Second Revised Stipulation correctly allocates to ratepayers the value of the use of BHE's name consistent with the provisional rule and the intent of 35-A M.R.S.A. § 707(3)(G).

The method for determining the value of good will contained in both the original and Second Revised Stipulation is inconsistent with the provisional rule's presumption that the value of goodwill (which includes the use of company name) is the lesser of one percent of the capitalization of the affiliate or two percent of the affiliate's gross revenues. The Second

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<sup>6</sup> CMP commented that the Commission might consider waiting to consider the Second Revised Stipulation until Chapter 820 is finally adopted after Legislative review. Because the Second Revised Stipulation provides that the determination of whether BHE is financially sound will be consistent with standards set forth in Chapter 820 as finally adopted and section 708 of Title 35-A, we do not agree that we should delay our consideration of the Stipulation. CMP also commented that the Commission's order should ensure that joint marketing activities are being accurately reported. We determine that BHE is required pursuant to this Order to report any joint marketing beyond BGC's minimal use of BHE's name. We expect that BHE will comply with this requirement.

<sup>7</sup> By recommending that the investment be allowed upon a showing of sound financial condition, we express no opinion on whether the project is a reasonable venture for BHE. Consistent with the Commission's policy expressed in the Chapter 820 rulemaking, the focus of our decision is not on any possible but uncertain benefits to BHE of participation in the BGC venture. Rather the focus is on whether BHE is in sound financial condition so as to ensure that ratepayers are adequately protected. Moreover, nothing in our approval of the Second Revised Stipulation may be construed as a prudence determination for ratemaking purposes. See 35-A M.R.S.A. §§ 707(3)(D) and 708(2-A).

Revised stipulation provides that the value of the use of BHE's name is equal to BGC's pretax net income and that payments made in accordance with this methodology should end on December 31, 2008 unless BGC continues to use BHE's name. If BGC continues to use BHE's name beyond the period ending on December 31, 2006, the annual payments based on two percent of BGC's pretax net income will continue, unless such continued payments are precluded under Chapter 820, as finally adopted. We conclude that that based on the limited use of BHE's name as described in data responses and at the technical conferences, a deviation from the methodology of the provisional rule is appropriate. As discussed above, the Second Revised Stipulation provides the additional safeguard of requiring BHE to report to the Commission if BHE and BGC decide to engage in joint marketing (beyond the minimal use of BHE's name as described in Advisors 01-26 and 02-09 **Confidential**).<sup>8</sup> This provision will allow the Commission to decide whether to redetermine the value of the good will used by BGC based on the additional use of this intangible.

#### VI. ADDITIONAL FILING REQUIREMENTS

At the conference of counsel, the Advisors suggested that some additional requirements for the supplemental filing would include:

- \* all recent credit reports
- \* a description of the impact of BHE's proposed capital contribution on BHE's credit capacity, ability to obtain capital on reasonable terms, and its ability to provide safe, reasonable and adequate service.

We add these requirements to those set forth in the Second Revised Stipulation. In addition, we invite BHE to submit with its supplemental filing a detailed proposal to ensure ratepayers are held harmless from the negative impacts of its proposed investment. For example, BHE could propose a method for removing the impact of the investment on cost of capital and compliance with debt covenants.

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<sup>8</sup> BHE has stated that the BGC letterhead will identify BGC as an affiliate of BHE and that Bangor Gas may indicate in various forms of advertising that it is an affiliate of BHE. It further stated that any reference to BHE would be minimal and that there was no anticipated marketing plan centered on the use of BHE's name.

Accordingly, we,

O R D E R

1. That the Original Stipulation is rejected;
2. That the Second Revised Stipulation attached hereto as Appendix A is approved consistent with this Order; and
3. That this Docket be left open for BHE to make its supplemental filing consistent with this Order.

Dated at Augusta, Maine, this 26th day of March, 1998.

BY ORDER OF THE COMMISSION

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Dennis L. Keschl  
Administrative Director

COMMISSIONERS VOTING FOR:      Welch  
   Hunt

COMMISSIONERS ABSENT:            Nugent<sup>9</sup>

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<sup>9</sup> Commissioner Nugent was present and voted to reject the original stipulation. He was absent from the vote approving the Second Revised Stipulation.

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of adjudicatory proceedings are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 6(N) of the Commission's Rules of Practice and Procedure (65-407 C.M.R.11) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which consideration is sought.
2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320 (1)-(4) and the Maine Rules of Civil Procedure, Rule 73 et seq.
3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320 (5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.